82-500

NO. 82-____

Office - Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE SOUTHLAND CORPORATION, *et al.*,

Appellants,

—v.—

RICHARD D. KEATING, *et al.*,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF CALIFORNIA

JURISDICTIONAL STATEMENT

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September 1982

QUESTIONS PRESENTED

1. Whether the federally protected right of arbitration under the Federal Arbitration Act is unlawfully impaired when a state court superimposes judicial class action procedures (including court-supervised discovery, briefing, certification, notice and opt-out procedures, mandatory preparation of transcripts, and ongoing judicial control) on a private arbitration of a commercial dispute involving interstate commerce.

2. Whether a state statute violates the Supremacy Clause of the United States Constitution when it invalidates arbitration agreements involving interstate commerce that are "valid, irrevocable, and enforceable" under the terms of the Federal Arbitration Act.

PARTIES BELOW

This appeal involves eight cases that were consolidated in the court below.* Plaintiffs, who are former franchised operators of 7-Eleven® convenience stores in the State of California, are Richard and Darla Keating, Edward and Betty Gouveia, Harry Battersby, Patrick and Cathy Cheng, Michael and Gloria Coy, Phillip and Joan Newell, Thomas and Wanda Sampson, and Arthur and Jenny Scovis. Some of the plaintiffs purport to represent a class consisting of all current and former 7-Eleven franchisees in California.

Defendants are The Southland Corporation, which owns the 7-Eleven® service mark, and several of its current and former officers, directors and employees: John P. Thompson, Jere W. Thompson, Walton Grayson, III, Joseph S. Hardin, R.G.

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* One additional case, *Garza* v. *Southland*, was originally consolidated with the others but has since been settled.

Smith, Eugene Pender, S.R. Dole, Terry De Bard, Gene Janssen, Curtis Pare, Ray Berry, Paul Stevenson, Michael Wildman, Robert Johnson, Ernest Arzabal, Michael Drury, Keith Jenkins, Robert Duncan, Fred Elwood, Joseph Galea, Dave Pava, Tal Colson and Douglas Porter.

Defendant The Southland Corporation has no parent corporation, subsidiaries (except wholly owned subsidiaries), or affiliates.

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Appellants,

—v.—

RICHARD D. KEATING, *et al.*,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF CALIFORNIA

JURISDICTIONAL STATEMENT

Appellants, The Southland Corporation and several of its current and former officers, directors and employees (hereinafter collectively referred to as "Southland"), appeal from a final judgment of the Supreme Court of California.

OPINIONS BELOW

The majority and dissenting opinions of the California Supreme Court are reported at 31 Cal. 3d 584, 183 Cal. Rptr. 360, 645 P.2d 1192 (1982), and are reprinted in the separate Appendix to this Jurisdictional Statement at 1a-45a (hereinafter "App."). The opinion of the California Court of Appeal, First Appellate District, is reported at 109 Cal. App. 3d 784, 167 Cal. Rptr. 481 (1980), and is reprinted at App. 47a-70a. The orders of the Superior Court of Alameda County (App. 71a-80a) are unreported.

JURISDICTION

The judgment of the Supreme Court of California was entered on June 10, 1982. Southland filed a timely notice of appeal in that court on August 24, 1982. (App. 83a-84a.) Upon timely application, Justice Rehnquist granted Southland an extension of time until September 22, 1982 to docket an appeal or, in the alternative, to file a petition for a writ of certiorari. (App. 85a.) The jurisdiction of this Court is conferred by 28 U.S.C. § 1257(2) (1976), because the California Supreme Court has sustained the validity of the California Franchise Investment Law and California class action rules notwithstanding Southland's contention that such statute and rules, as construed, violate the Constitution and laws of the United States.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The following constitutional provisions and statutes are involved in this appeal and are set forth in the separate Appendix to this Jurisdictional Statement (App. 87a-88a): the Supremacy Clause of the United States Constitution (art. VI, cl. 2); the Due Process Clause of the Fourteenth Amendment to the Constitution; Sections 1-3 of the Federal Arbitration Act, 9 U.S.C. §§ 1-3 (1976); and Section 31512 of the California Franchise Investment Law, CAL. CORP. CODE § 31512 (West 1977).

STATEMENT OF THE CASE

This appeal involves an unprecedented decision of the California Supreme Court, holding that individual franchisees, who agreed to arbitrate any disputes arising under their interstate franchise agreement, could file a judicial action, asking the court to direct their arbitration claim to proceed on a "class action" basis. The court rejected Southland's argument that

this state-imposed, judicial procedure would violate the Supremacy Clause of the United States Constitution by impairing the exercise of substantive rights protected by the Federal Arbitration Act, title 9, U.S.C. (1976), and would violate the Due Process Clause of the Fourteenth Amendment unless the court exercised strict control over the arbitration.

This appeal also concerns the California Supreme Court's holding that the California Franchise Investment Law, CAL. CORP. CODE §§ 31000-31516 (West 1977), preempts the Federal Arbitration Act and renders arbitration agreements unenforceable with respect to claims brought by franchisees against franchisors under that statute. The court rejected Southland's argument that the Federal Arbitration Act preempts anti-arbitration statutes such as the California franchising statute. The decision of the California Supreme Court on both the class action issue and the preemption issue is in conflict with decisions of other state and federal courts and has widespread implications affecting the viability of arbitration throughout the country.

This litigation began in May 1977 with the filing of an action by Richard and Darla Keating in the Superior Court for Santa Clara County, California. Plaintiffs were franchised operators of a 7-Eleven convenience store. They alleged that their franchisor, Southland, had utilized an accounting system in preparing financial statements for their store that was unfair and inaccurate and that representatives of Southland had made certain fraudulent representations concerning the accounting system. Southland's conduct was alleged to give rise to several related causes of action, including common law fraud, breach of contract, breach of fiduciary duty and a violation of the California Franchise Investment Law.[1] Plaintiffs purported to

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1 The California Franchise Investment Law requires franchisors to make certain disclosures to prospective franchisees, and prohibits franchisors from making fraudulent or misleading statements to those prospective franchisees. In essence, it establishes a specific statutory cause of action for certain fraudulent conduct. Plaintiffs' claim under this statute is based on the same facts as, and is largely duplicative of, plaintiffs' various common law causes of action.

represent a class of all current and former 7-Eleven franchisees in California.[2] Thereafter, similar complaints were filed by the other appellees herein, and the actions were consolidated for pretrial proceedings in the Superior Court for Alameda County.[3]

Pursuant to an arbitration clause in plaintiffs' franchise agreements, which provided that the parties would arbitrate "any controversy or claim arising out of or relating to this Agreement or the breach hereof . . . in accordance with the Rules of the American Arbitration Association . . . ," Southland moved to compel arbitration in each of the cases. Plaintiffs argued, among other things, that their claims based on the California Franchise Investment Law were nonarbitrable.[4] Southland responded that if the state statute were interpreted as plaintiffs urged to contain an anti-arbitration policy, then it would be contrary to the Federal Arbitration Act and invalid under the Supremacy Clause of the United States Constitution.

As a fallback position, plaintiffs suggested that if their claims were arbitrable, the court should create a procedure whereby the arbitration would be conducted as a class action. Plaintiffs did not seriously pursue this issue in the Superior Court.

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2 Plaintiffs' original complaint alleged a class consisting of all current and former 7-Eleven franchisees in the United States, but the scope of the purported class was narrowed to California franchisees in an amended complaint filed in December 1977. Plaintiffs alleged that there were about 800 persons in this narrowed class.

3 Some of the consolidated cases were commenced prior to the *Keating* case. However, after *Keating* had been filed, amended complaints were filed in these cases to conform their allegations to those of the newly-filed complaint in *Keating*. These amended pleadings substantially changed the focus of those earlier cases. *See* App. 21a-22a.

4 Plaintiffs also contended that Southland had waived its right to arbitrate and that the agreements were unenforceable adhesion contracts. However, the California Supreme Court rejected these arguments on the basis of the law and the facts. (App. 5a-8a, 19a-23a.) The "waiver" and "adhesion contract" issues are not involved in this appeal.

The Superior Court held that plaintiffs were required to arbitrate their claims of common law fraud, breach of contract and breach of fiduciary duty, but not their claims under the Franchise Investment Law. (*See* App. 72a, 74a, 79a.)[5] The court did not reach the issue whether the arbitration should proceed as a class action.

The California Court of Appeal rejected plaintiffs' argument that the Franchise Investment Law contains an anti-arbitration policy. (App. 66a-68a.) It further concluded that if the statute were so interpreted, it would be invalid with respect to contracts involving interstate commerce, because the Federal Arbitration Act provides that such arbitration agreements are "valid, irrevocable, and enforceable." (App. 68a-70a.) The court therefore held that the Franchise Investment Law claims were arbitrable along with the remainder of plaintiffs' causes of action. (App. 70a.) The Court of Appeal also ruled, however, that there is no "insurmountable obstacle" to conducting an arbitration on a class-wide basis (App. 63a), and it remanded the cases to the trial court for class certification proceedings, since such proceedings could not constitutionally be conducted by an arbitral tribunal. (App. 64a.)

The California Supreme Court, by a divided vote of 4-2, ruled on both of these issues. First, it reversed the Court of Appeal's ruling that claims asserted under the California Franchise Investment Law are arbitrable. The court concluded that the California legislature intended to render arbitration agreements unenforceable with respect to claims based on that

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5 The Superior Court's orders did not explain the reasons for denying arbitration of the Franchise Investment Law claims. However, the trial judge later explained on the record (i) that in his view the arbitration clause in the 7-Eleven franchise agreement was not broad enough to include these claims, and (ii) that he therefore had not reached plaintiffs' argument that Franchise Investment Law claims were nonarbitrable. Transcript of Hearing of July 19, 1978, at 20-24, *Market Franchise Cases*, Cal. Jud. Council Coord. No. 387 (Cal. Super. Ct., Alameda Co.). The Superior Court's narrow construction of the contract was reversed by the California Court of Appeal (App. 65a-66a), and that ruling was not disturbed by the California Supreme Court.

statute. It held further that anti-arbitration statutes of this kind do not contravene the federal substantive law embodied in the Federal Arbitration Act. (App. 8a-18a.)

Second, the California Supreme Court affirmed the Court of Appeal's ruling on the availability of a class action arbitration procedure. (App. 23a-30a.) It stated that California public policy favors class actions and that, in some cases, this procedure might be fairer than an individual arbitration. It therefore held that a class action arbitration could be imposed on the parties without their mutual consent. The majority did not directly address Southland's argument that this pro-class action policy is overridden, at least with respect to interstate contracts such as those at issue here, by the federal statutory policy favoring simple, quick, inexpensive and nonjudicial arbitrations. The court acknowledged, however, that a judicially ordered classwide arbitration "would entail a greater degree of judicial involvement than is normally associated with arbitration," including "a measure" of ongoing judicial supervision "in order to safeguard the rights of absent class members to adequate representation and in the event of dismissal or settlement." (App. 28a-29a.) The court contemplated that the trial court would authorize discovery and briefing on the class action issue; determine whether a class action was appropriate; supervise any notice and opt-out procedures; oversee the arbitration proceedings themselves to ensure that the interests of the class were being adequately represented by the named claimants and adequately protected by the arbitrators; and review any decision to dismiss or settle the dispute. (*See* App. 29a.) The majority recognized that the trial court would necessarily walk a thin and sensitive line between adequate supervision and inappropriate intrusion: It observed that the trial court would need to use "a good deal of care, and ingenuity" in order to supervise the arbitration proceedings in these ways while "avoid[ing] judicial intrusion upon the merits" and "minimiz[ing] complexity, costs, or delay." (App. 29a.)

The dissenting justices in the California Supreme Court (Richardson and Mosk, JJ.) disagreed with both rulings. First,

with respect to the California Franchise Investment Law issue, they referred to the long line of authority establishing that the Federal Arbitration Act creates a body of federal substantive law that supersedes any anti-arbitration policies at the state level with respect to interstate arbitration agreements. (App. 32a-34a.) They disagreed with the majority's view that the states are free to carve out exceptions to the coverage of the federal statute, and concluded that the majority opinion's "chances of surviving federal review are very dubious." (App. 37a.)

Second, the dissenting justices found that class action arbitrations would be "fundamentally contrary to the purpose of arbitration and to the public policy encouraging arbitration." (App. 44a.) The dissenters noted the absence of statutory or precedential authority for the procedure; catalogued ways in which courts inevitably would supervise and review arbitrators' actions; and then concluded that the majority's newly-fashioned procedure "would tend to make arbitration inefficient instead of efficient, lengthy instead of expeditious, and procedural instead of informal." (App. 41a.)

THE QUESTIONS ARE SUBSTANTIAL

The decision of the California Supreme Court constitutes a substantial threat to the efficacy and viability of private arbitration as an alternative to judicial proceedings. The decision seeks to establish the right of state legislatures to enact statutes restricting the coverage of the Federal Arbitration Act, and, with respect to other, arbitrable claims, it encumbers and eviscerates arbitration by imposing precisely the kinds of judicial procedures that arbitration was designed to avoid.

The California court's decision on the class action issue is unprecedented. No state or federal court has ever previously suggested that it would be proper to engraft class action procedures—and the close judicial supervision that necessarily comes with those procedures—onto private arbitration proceedings.

The California court's decision on the Franchise Investment Law issue improperly attempts to preempt federal substantive law relating to interstate commerce and is in conflict with numerous rulings by other federal and state courts. These courts have held that interstate arbitration contracts are governed by the Federal Arbitration Act, which provides that arbitration agreements shall be "valid, irrevocable, and enforceable . . . ."

Unless it is overturned by this Court, the California Supreme Court's decision will promote forum shopping and will restrict the arbitrability of claims both within and outside of California. Moreover, the outcome of this case will determine whether state legislatures and courts are free to adopt statutes and policies overriding the Federal Arbitration Act.

The Federal Arbitration Act was enacted in 1925 for the specific purposes of (i) providing an alternative to lengthy, expensive, formalized court actions and (ii) overruling state anti-arbitration policies where interstate commerce is involved.[6] These policies are even more important today than they were then. The judicial system has become burdened with an increasingly heavy workload, and lawsuits have become more costly, protracted and complex than they were in 1925.[7] It

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6 H.R. REP. NO. 96, 68th Cong., 1st Sess. 1-2 (1924); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-11 (1974); *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967). *See* S. REP. NO. 536, 68th Cong., 1st Sess. 2-3 (1924); *Arbitration of Interstate Commercial Disputes: Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary*, 68th Cong., 1st Sess. 34-35 (1924) (brief submitted by American Bar Association).

7 From 1940 to 1981, annual federal district court civil case filings increased from approximately 35,000 to 180,000. Federal civil cases increased almost six times as fast as population, and despite a significant increase in the number of federal district court judges, the yearly civil filings per judgeship almost doubled between 1940 and 1981, from approximately 180 to 350 cases. Class action cases are responsible for a significant degree of the burdens imposed upon judges. *See* ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, 1981 ANNUAL REPORT OF THE DIRECTOR 3-4, 56-59, 82-83 (Prelim. ed. 1981); ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, 1980 ANNUAL REPORT OF THE DIRECTOR 2-4,

is therefore of the utmost importance for this Court to prevent the erosion of arbitration as a meaningful alternative to the judicial method of dispute resolution.

A. The Viability of Arbitration Under the Federal Arbitration Act Depends on Its Freedom from the Strict Judicial Controls and Procedures Required by the Decision Below.

1. *Arbitration Is a Highly Favored Alternative to Litigation in the Courts.*

Arbitration is a contractual method of dispute resolution that is intended to take place outside the judicial system, without interference by the courts and without adherence to conventional judicial procedures. By choosing arbitration, parties elect to have one or more nonjudicial umpires of their choosing, often experts in the subject matter of the dispute, hold an informal, prompt hearing and reach a fair decision. The arbitrators need not be lawyers, for the process they administer is not legalistic. They enjoy wide latitude in conducting the proceedings. Judicial procedures—such as pretrial discovery, the rules of evidence, the right to appeal, a written transcript, and the necessity of rendering carefully articulated written decisions—are not applicable. Parties frequently conclude that lawyers are unnecessary in this informal setting. Moreover, arbitrators, unlike courts, need not consider the impact of their decisions as precedent that may be applicable to nonparties to the controversy. Arbitration thereby facilitates prompt decisions and discourages parties from overlitigating a dispute because of concerns that an adverse decision may extend beyond the particular facts at issue.[8]

54-58 (1980); Burger, *Isn't There a Better Way*, 68 A.B.A.J. 274, 275 (1982) (address to ABA). *See also* Kirkham, *Problems of Complex Civil Litigation*, 83 F.R.D. 497, 499-501 (1979) (congestion in courts). The congestion is not confined to the federal courts. *See, e.g., Judicial Conference for the District of Columbia Circuit*, 89 F.R.D. 169, 175 (1980) (remarks of Burger, C.J.).

[8] *See, e.g., Bernhardt* v. *Polygraphic Co. of America*, 350 U.S. 198, 203 & n.4 (1956); *United Steelworkers* v. *Enterprise Wheel & Car*

When Congress enacted the Federal Arbitration Act, it sought to protect the right of parties to interstate contracts to elect arbitration as an alternative to judicial litigation. Prior to the Act, courts in a number of states had held arbitration to be contrary to public policy, so Congress expressly provided, in Section 2 of the statute, that interstate arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The courts have uniformly held that the Act establishes a strong federal policy favoring arbitration and that this procedure should be protected from any efforts to dilute its effectiveness.[9] Thus, under the Supremacy Clause of the Constitution (art. VI, cl. 2), the states cannot apply their own statutes and rules to interstate arbitration agreements if those policies would constitute "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *E.g., Chicago & N.W. Transp. Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311, 317 (1981). *See also* cases cited *infra* at 25-26.

The strong federal policy favoring arbitration was recently reiterated by Congress in enacting the patent and trademark appropriations bill for 1983-85. Pub. L. No. 97-247 (1982). Congress included a provision in that statute which overrules judicial decisions holding that disputes concerning patent validity or infringement are nonarbitrable. *Id.* § 17(b). In explaining the purpose of this provision, the House Report

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Corp., 363 U.S. 593, 598 (1960). For a discussion of the informality of arbitration and its differences from judicial litigation, *see generally* A. Widiss, Arbitration: Commercial Disputes, Insurance, and Tort Claims 6-7, 339 (PLI 1979); Domke on Commercial Arbitration § 24.02 at 235-39, § 24.07 at 252, § 25.01 at 255-56, § 26.01 at 265-66, § 27.01 at 271-72, § 29.06 at 286-89, and pp. 312-13 (1968); Rehnquist, *A Jurist's View of Arbitration*, 32 Arb. J. 1, 5-7 (1977); Brown, *Some Practical Thoughts on Arbitration*, 6 Litigation 8, 8-10 (Winter 1980).

9 *See, e.g., Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F.2d 402, 406-07, 410 (2d Cir. 1959), *cert. dismissed*, 364 U.S. 801 (1960); *Galt* v. *Libbey-Owens-Ford Glass Co.*, 376 F.2d 711, 714 (7th Cir. 1967); *J.S. & H. Construction Co.* v. *Richmond County Hospital Authority*, 473 F.2d 212, 214-15 (5th Cir. 1973).

emphasized that arbitration benefits not only the parties to a particular dispute but also the public at large by reducing the burdens on the courts:

> The advantages of arbitration are many: it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices; and, arbitrators are frequently better versed than judges and juries in the area of trade customs and the technologies involved in these disputes.
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> The enforcement of voluntary arbitration would serve the public in two ways. First, . . . [it] will enhance the patent system . . . . Secondly, arbitration could relieve some of the burdens on the overworked Federal courts. Chief Justice Burger in his speech to the American Bar Association on January 24, 1982, generally endorsed the use of arbitration to reduce the judicial backlog.[10]

2. *The Essence of Arbitration Is Its Avoidance of Judicial Procedures; Class Actions Require Active Judicial Involvement.*

Waiver of judicial procedures goes to the heart of arbitration. Arbitration "isn't 'just like the courts.' In fact, its strongest points lie in those areas where it most widely differs from the courts." DOMKE ON COMMERCIAL ARBITRATION § 1.01, at 2. Thus, it has repeatedly been held that arbitration should not be encumbered with procedures that might delay or complicate the proceedings, or require judicial intervention when the arbitration is in progress.[11] As Judge Learned Hand

10 H.R. Rep. No. 542, 97th Cong., 2d Sess. 13 (1982). *See also Report of the Pound Conference Follow-Up Task Force*, 74 F.R.D. 159, 166, 169, 179-81 (1976) (discussing the advantages of arbitration and recommending its increased use).

11 *See, e.g., Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. at 404; *Cavanaugh* v. *McDonnell & Co.*, 357 Mass. 452, 457, 258

stated in *American Almond Products Co.* v. *Consolidated Pecan Sales Co.*, 144 F.2d 448, 451 (2d Cir. 1944):

> Arbitration may or may not be a desirable substitute for trials in courts; as to that the parties must decide in each instance. But when they have adopted it, they must be content with its informalities; they may not hedge it about with those procedural limitations which it is precisely its purpose to avoid.

The court below has done precisely that. It has imposed a *judicial* mechanism which is radically different than the informal procedure agreed to by the parties, and which has a profound impact on the scope, costs, risks and procedures of the litigation. Indeed, class actions are the paradigm example of large, time-consuming, rigorously-regulated, difficult-to-manage judicial procedures.

Class actions require a much greater degree of judicial supervision, and more rigid adherence to formalities, than other court proceedings. Because they bind the rights of persons who have not sued and who do not control the lawsuit, class actions pose delicate constitutional issues. They satisfy due process standards only if and to the extent that the named plaintiff's claim is typical of those of other class members, the best practicable notice is given to the class, and the named plaintiff and his counsel fully and adequately protect the interests of the class.[12]

In a class action, absent class members cannot constitutionally be bound by the result of the proceeding unless there has been careful and active judicial participation in virtually all aspects of the litigation. For example, discovery, briefing and a

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N.E.2d 561, 564 (1970); *De Sapio* v. *Kohlmeyer*, 35 N.Y.2d 402, 406, 362 N.Y.S.2d 843, 847, 321 N.E.2d 770, 773 (1974).

12 *See Hansberry* v. *Lee*, 311 U.S. 32, 42-43, 45 (1940); *Sam Fox Publishing Co.* v. *United States*, 366 U.S. 683, 691 (1961); *H.L.* v. *Matheson*, 450 U.S. 398, 432 n.9 (1981) (Marshall, J., dissenting); *Robertson* v. *National Basketball Ass'n*, 556 F.2d 682, 685-86 (2d Cir. 1977); *Gonzales* v. *Cassidy*, 474 F.2d 67, 74 (5th Cir. 1973).

hearing are usually required before the court decides whether to certify a class.[13] The court must carefully define the class, determine the best practicable form of notice to the class, and approve the content of the notice;[14] and class members must be allowed to opt out of the litigation.[15] After completion of these preliminary proceedings, which normally consume many months,[16] the court must continue to supervise all phases of the litigation to ensure that plaintiff's case is based on evidence common to the class, that plaintiff's interests are compatible with those of the class, and that plaintiff is a vigorous, effective and adequate class representative.[17] If, at *any* time, the initial class certification appears to have been erroneous, the class must be realigned or decertified.[18] If plaintiff's claims

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13 *See General Telephone Co.* v. *Falcon*, 102 S. Ct. 2364, 2372 (1982) (often necessary to "probe behind the pleadings" to decide class issues); *Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 469 & n.12 (1978) (class issues usually " 'enmeshed in the factual and legal issues comprising the plaintiff's cause of action' "); *Alabama* v. *Blue Bird Body Co.*, 573 F.2d 309, 312, 322-24 (5th Cir. 1978); *Belcher* v. *Bassett Furniture Industries, Inc.*, 588 F.2d 904, 906 (4th Cir. 1978).

14 *Oppenheimer Fund, Inc.* v. *Sanders*, 437 U.S. 340, 357 n.24 (1978); *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 173-74 (1974).

15 FED. R. CIV. P. 23(c). *See also* the decision of the California Supreme Court at App. 28a.

16 Frequently, a year or more will be consumed in class action discovery, briefing and hearings alone. *See, e.g., In re Transit Co. Tire Antitrust Litigation*, 67 F.R.D. 59, 63, 72 (W.D. Mo. 1975); *Sommers* v. *Abraham Lincoln Federal Savings & Loan Ass'n*, 66 F.R.D. 581, 585 (E.D. Pa. 1975).

17 *E.g., In re Fine Paper Antitrust Litigation*, 617 F.2d 22, 27 (3d Cir. 1980); *Susman* v. *Lincoln American Corp.*, 561 F.2d 86, 89-90 (7th Cir. 1977); *National Ass'n of Regional Medical Programs, Inc.* v. *Mathews*, 551 F.2d 340, 344-46 (D.C. Cir. 1976), *cert. denied*, 431 U.S. 954 (1977).

18 *General Telephone Co.* v. *Falcon*, 102 S. Ct. at 2372; *Coopers & Lybrand* v. *Livesay*, 437 U.S. at 469 & n.11; *H.L.* v. *Matheson*, 450 U.S. at 432 n.11 (Marshall, J., dissenting); *Social Services Union, Local 535* v. *County of Santa Clara*, 609 F.2d 944, 948-49 (9th Cir. 1979); *Guerine* v. *J & W Investment, Inc.*, 544 F.2d 863, 864 (5th Cir. 1977).

are amended, or if other significant events occur, the court may require or authorize supplemental notices to the class.[19] If either the plaintiff or the defendant wishes to communicate with class members, the court may act to prevent misrepresentations or other abuses.[20] At trial, the court must ensure that plaintiff's evidence is "common," class-wide evidence.[21] After trial of the "common" issues, there may be hundreds of additional hearings on "individual" issues, such as damages.[22] Transcripts of the proceedings must be prepared, and the court must render written decisions, so that other courts can ascertain the scope of the class, the judgment, etc. After all issues of liability and damages have been resolved, a class member might seek to appeal from, or to avoid the res judicata effects of, the verdict by contending that the evidence was not "common" and/or that he was not adequately represented; if he was not, then the verdict cannot be binding on him.[23] In a class action, the parties cannot even settle their dispute without judicial review and approval: Due process requires that class members be given notice of the settlement, and if a class member objects, he must receive an opportunity for a hearing; the court must then determine whether the terms of the compromise are fair in view of the strengths and weaknesses of plaintiff's case, and other factors.[24] In short, class actions require intimate, ongoing judicial management at every stage.

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19 *See, e.g.*, FED. R. CIV. P. 23(d)(2); 7A C. WRIGHT & A. MILLER, FEDERAL PRACTICE & PROCEDURE § 1791 at 193-94, § 1793 at 201, 207-11 (1972).

20 *Gulf Oil Co.* v. *Bernard*, 452 U.S. 89, 100 (1981).

21 *See General Telephone Co.* v. *Falcon*, 102 S. Ct. at 2372.

22 *E.g., International Brotherhood of Teamsters* v. *United States*, 431 U.S. 324, 361 (1977); *EEOC* v. *Korn Industries, Inc.*, 662 F.2d 256, 260-61 (4th Cir. 1981); *Green* v. *Wolf Corp.*, 406 F.2d 291, 301 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969).

23 *E.g., Gonzales* v. *Cassidy*, 474 F.2d 67 (5th Cir. 1973).

24 *In re General Motors Corp. Engine Interchange Litigation*, 594 F.2d 1106, 1124 & n.21 (7th Cir.), *cert. denied*, 444 U.S. 870 (1979); *Mandujano* v. *Basic Vegetable Products, Inc.*, 541 F.2d 832, 835-36 (9th Cir. 1976); *Grunin* v. *International House of Pancakes*, 513 F.2d

The California Supreme Court recognized that these essential procedures, which arise from due process considerations, cannot properly be performed by arbitrators—who often are not even lawyers, much less judges. The California Supreme Court therefore acknowledged that in a purported class action arbitration *the court*, and not the arbitrators, would conduct the certification proceedings, monitor the adequacy of representation, review any proposed settlements, and so forth. (App. 28a-29a. *See also* the decision of the Court of Appeal at App. 64a.) The court below attempted to downplay the extent to which a judge would be involved but expressly conceded that the judiciary would be required to participate actively in several aspects of the litigation.[25]

3. *A Class Action Arbitration Would Destroy the Parties' Agreement To Arbitrate.*

It is difficult to imagine a procedure more alien to the spirit of arbitration. The procedure contemplated by the court below would seriously affect the viability of the rights guaranteed by the Federal Arbitration Act in many ways. For example:

— a procedure designed to operate outside the judicial system would require careful and continuous judicial participation;

— a mechanism intended to operate informally would be transformed into one involving detailed, legalistic procedures;

— a procedure designed to simplify the litigation would become more complex than if the litigation had re-

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114, 120-24 (8th Cir.), *cert. denied*, 423 U.S. 864 (1975); *Greenfield* v. *Villager Industries, Inc.*, 483 F.2d 824, 831-34 (3d Cir. 1973). *See also* FED. R. CIV. P. 23(e).

25 Even where the complications of a class action are not present, it is difficult for a court to play only a limited role in an arbitration. As one commentator has noted: "[O]nce a court gets into an arbitration proceeding, it has almost no way to get out of it. Pretrial discovery procedures require continual supervision." G. GOLDBERG, A LAWYER'S GUIDE TO COMMERCIAL ARBITRATION 41 (ALI-ABA 1977).

mained in court in the first place; the parties would litigate their dispute in two forums rather than one, and there would be substantial overlaps between the roles of the judge and arbitrator;

— a mechanism intended to be quick and inexpensive would become protracted and expensive;

— a procedure designed to permit parties to resolve a dispute privately, and without disrupting ongoing contractual relationships, would become a highly publicized, high-stakes lawsuit;

— a procedure designed to facilitate compromise would inhibit settlements by burdening them with costly and time-consuming procedural hurdles;

— parties would be less willing to enter into arbitration agreements since the risks associated with arbitration would be significantly increased while its efficiency and privacy would be diminished; and

— individual lawyers, accountants, architects, etc., would be less willing to volunteer their services as arbitrators, because few of them will have the time, patience or ability to participate in a massive proceeding of the kind contemplated by the California Supreme Court.

Class actions and arbitrations are each a useful procedural tool for resolving disputes. This Court need not decide that one is good, and the other bad. But the two are like oil and water and cannot be mixed, for the use of both at the same time would not be true to the objectives or procedures of either. One emphasizes speed, simplicity, informality and privacy, while the other requires caution, complexity, strict adherence to established procedures, and publicity.

This fundamental inconsistency between the two types of proceedings was recognized in the only other reported decision to consider the propriety of class action arbitration. In *Harris* v. *Shearson Hayden Stone, Inc.*, 82 A.D.2d 87, 441 N.Y.S.2d 70, 75-76 (1981), *aff'd mem.*, 56 N.Y.2d 627, 450 N.Y.S.2d

482, 435 N.E.2d 1097 (1982), the court held that a party should not be permitted to avoid arbitration of his individual claim by filing a class action in court. A dissenting justice felt that the policy favoring class actions should prevail over the policy favoring arbitration, but even he recognized that a class action necessarily is a *judicial* procedure, unsuited to the arbitration setting. 441 N.Y.S.2d at 79.

The California Supreme Court ignored this obvious incompatibility and justified its decision by erroneously assuming that individual, small claims might be "effectively foreclos[ed]" unless claimants are able to aggregate their resources by bringing class actions. (App. 25a.) The court overlooked the fact that the objectives of class actions (relieving burdens on the courts, reducing the cost of prosecuting individual claims) are served by arbitration in another way. Arbitration assists the administration of justice by consensually removing cases from the often tortuous route of the judicial system and by providing a quick, informal, inexpensive remedy to facilitate the prosecution of claims—particularly small claims. In other words, arbitration satisfies the principal goals that led to the creation of class actions without the delay, burden and expense which accompanies that procedure. *Cf. Harris* v. *Shearson Hayden Stone, Inc.*, 441 N.Y.S.2d at 76. The California Supreme Court's contrary assertion is unsupportable and should be rejected.[26]

The California Supreme Court was unrealistic when it suggested that hundreds or thousands of individual, duplicative arbitrations would occur unless it created an unprecedented class action procedure. (*See* App. 25a-29a.) The court cited no evidence to support the hypothesis that this sort of wasteful practice has occurred—either in the 7-Eleven convenience store

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26 Our research has not revealed any studies that support the proposition that individual arbitration has tended to thwart the prosecution of individual claims. Nor is there any support for that proposition in case law or commentary prior to this litigation. Moreover, the plaintiff-franchisees in the court below did not allege that it would be impossible or impractical to prosecute individual claims. Indeed, all of the plaintiffs are represented by the same attorneys and yet they filed some of the cases individually and some as purported class actions.

system or elsewhere—and we believe such evidence does not exist for several reasons. First, the typical case involves only one or a few claims, not hundreds or thousands. Class actions stir up litigation to some extent by creating claimants who have not previously felt aggrieved and who are not affirmatively interested in filing suit.[27] Thus, the true alternative to a class action in the instant litigation, and most others, is arbitration with a few claimants, not hundreds. Second, even if hundreds of claims were asserted, it is wrong to assume that it would be necessary to duplicate the expense of arbitrating each one individually. To the extent that the individual claims involved similar issues, the claimants could achieve substantial economies by retaining the same attorneys (as plaintiffs have done here), hiring the same expert witnesses, and so forth. Third, hundreds of repetitive proceedings would not benefit either side. In the real world, parties to contracts would probably agree to consolidate similar claims, or, if a number of arbitrations were decided in favor of one side or the other, they would likely conform their conduct to the results of those arbitrations. Fourth, if a party did attempt to engage in wasteful relitigation of hundreds of identical claims, arbitrators would at some point give precedential weight to the outcome of prior cases. Fifth, in positing that the "alternatives" were a single class action or hundreds of individual hearings, the court below overlooked the fact that a class action arbitration would *not* eliminate the need for hundreds of individual trials on "non-common" issues such as individualized damages, affirmative defenses and counterclaims.

In any event, the Federal Arbitration Act does not permit a court to upset the agreement of the parties on the ground that some other procedure would be more "efficient" in the particular case.[28] As the court stated in *Dickinson* v. *Heinold Securities, Inc.*, 661 F.2d 638, 646 (7th Cir. 1981):

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27 *Cf. Gulf Oil Co.* v. *Bernard*, 452 U.S. at 100 nn.11, 12 (potential of class action for "stirring up" litigation).

28 *See Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 519 ("An agreement to arbitrate before a specified tribunal is, in effect, a specialized kind of forum-selection clause that posits not only the situs of the suit but

> [T]he Arbitration Act requires that we enforce the bargain of the parties as to dispute resolution and not substitute our own views of economy and efficiency. There is no room in the language of the Act, the decisions of the Supreme Court or the decisions of this court for an ad hoc approach, based on speculative considerations of efficiency toward enforcement of arbitration agreements.

Or, as the New York Court of Appeals has stated:

> The courtroom may not be used as a convenient vestibule to the arbitration hall so as to allow a party to create his own unique structure combining litigation and arbitration.

De Sapio v. *Kohlmeyer,* 35 N.Y.2d at 406, 362 N.Y.S.2d at 847, 321 N.E.2d at 773.

The California Supreme Court missed the mark when it attempted to analogize class action arbitrations to situations in which some lower courts have *consolidated* two separate arbitrations involving a common set of facts and three parties (*e.g.*, X initiates an arbitration with Y and Y files an arbitration demand against Z in a single dispute relating to a construction contract). (*See* App. 26a-28a.) As the dissenters recognized, the two situations are quite different. (App. 41a-42a.)[29] Consolidation of two arbitrations merely brings all three parties into one proceeding so that their mutually interdependent rights and liabilities can be adjudicated at one time. Significantly, it did not appear in any of the decided cases that consolidation would increase the duration or costs of the proceeding or the amount in controversy, that consolidation would pose manageability problems such as those presented by class actions, or that consolidation would interfere with the

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also *the procedure to be used* in resolving the dispute.") (emphasis supplied).

29 The dissenting justices also correctly noted that the authority of courts to compel parties to consolidate separate arbitrations is unsettled. (App. 42a.)

ability of the arbitrators to conduct the proceedings as they saw fit.[30] The courts in those cases were able to make a clear-cut, one-time decision whether the arbitrations should go forth separately or together, and could thereafter divorce themselves from the conduct of the proceedings. Moreover, in the consolidation setting each party can be personally represented rather than being forced to rely on the hope that someone else will adequately protect his interests. Thus, those cases did not involve any of the due process and impairment-of-arbitration issues presented here.

The California Supreme Court recognized that its class action procedure would be radically different than a normal arbitration and accordingly held that a party "should be given the option of remaining in court rather than submitting to classwide arbitration." (App. 30a.) A person presented with this Hobson's choice would almost surely elect the judicial forum. A class action arbitration would involve overlapping responsibility between two tribunals and would be even more complex, protracted and uncertain than a *judicial* class action. Moreover, while parties to contracts are often willing to forego their rights of appeal, discovery and adherence to rules of evidence in the context of an informal arbitration, waiver of these protections would involve decidedly different considerations in the context of a massive class action involving hundreds of litigants. Thus, the net result of a class action arbitration would be to take the controversy out of arbitration and back into court, effectively terminating the agreement to arbitrate.

As noted, the objective of the Federal Arbitration Act is to validate arbitration agreements in interstate commerce and to protect them from efforts by individual states to require the use of dispute-resolution procedures other than those chosen by the parties. The California Supreme Court's radical departure from established arbitration procedures thus presents substantial issues affecting the administration of justice and of federally protected rights, warranting close scrutiny by this Court.

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30 *See* the cases cited by the court below at App. 26a-27a.

B. The Federal Arbitration Act Supersedes the Anti-Arbitration Policy of the California Franchise Investment Law.

Under Section 2 of the Federal Arbitration Act, interstate arbitration agreements are "valid, irrevocable, and enforceable," and can be avoided only on the basis of legal or equitable principles that permit the revocation "of any contract." 9 U.S.C. § 2. This means that an agreement can be invalidated on the basis of *general principles* that are applicable to *any* contract (*e.g.*, fraud, duress, lack of legal capacity, waiver), but not on the basis of restrictive principles that are aimed at arbitration agreements in particular.[31]

The California Franchise Investment Law requires franchisors to make certain disclosures to prospective franchisees and renders unlawful the making of materially false or misleading statements. Aggrieved franchisees are given a cause of action, and Section 31512 of the statute renders unenforceable any agreement by a franchisee to waive rights given to him by the Franchise Investment Law. As interpreted by the court below,[32] any arbitration agreement constitutes a waiver of rights and accordingly is void under the state statute. This is true regardless of whether an agreement is entered into voluntarily by

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31 *E.g.*, *Collins Radio Co.* v. *Ex-Cell-O Corp.*, 467 F.2d 995, 997-98 (8th Cir. 1972); *Commonwealth Edison Co.* v. *Gulf Oil Corp.*, 541 F.2d 1263, 1268-70 (7th Cir. 1976); *Supak & Sons Mfg. Co.* v. *Pervel Industries, Inc.*, 593 F.2d 135, 137 (4th Cir. 1979).

32 The California Supreme Court was quite willing to discern an anti-arbitration policy in the California Franchise Investment Law, even though the state legislature had not addressed the subject in the statute. The California Franchise Investment Law contains no express provision prohibiting arbitration or even mentioning the subject of arbitration. Nor does the legislative history of the statute refer to arbitration. In contrast, another California statute, the California Franchise Relations Act, CAL. BUS. & PROF. CODE § 20040 (West 1982 Supp.), expressly declares that franchise disputes arising under that statute *are* arbitrable, and the California Supreme Court below was hard-pressed to explain why it would be appropriate to arbitrate controversies under one franchising statute but not the other. (*See* App. 12a-13a.)

persons with legal capacity, regardless of whether it satisfies all other requisites for the making of a valid contract, and regardless of whether it provides for an impartial decision under rules such as those of the American Arbitration Association.[33]

The premise of the California Franchise Investment Law, as construed by the state supreme court, is that arbitration of certain franchise disputes is inherently unfair or inappropriate (for reasons that the court below was at a loss to explain). Accordingly, the statute invalidates arbitration agreements between franchisors and franchisees, although such a legal impediment is not even-handedly applicable to all contracts. This policy might be valid as to strictly intrastate agreements, but it directly contravenes Section 2 of the Federal Arbitration Act and is therefore invalid with respect to interstate contracts.

The California Supreme Court based its contrary decision on a purported analogy between the state Franchise Investment Law and federal Securities Act of 1933, both of which require disclosures to prospective investors. It reasoned that since this Court had declared in *Wilko* v. *Swan*, 346 U.S. 427 (1953), that preexisting arbitration agreements are nonbinding as to claims arising under the federal statute, the same result should pertain to claims arising under the analogous California statute.

The analogy to *Wilko* is invalid on several grounds.[34] The most important is that *Wilko* did not involve a conflict be-

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33 The California Supreme Court did not base its decision on any finding that the 7-Eleven arbitration agreement is one-sided or that it would give any unfair advantage to the franchisor. The arbitration clause in the 7-Eleven franchise agreement stipulates that the rules of the American Arbitration Association shall be applied. These established rules, which have been incorporated into tens of thousands of commercial agreements across the country, provide, *inter alia*, for the selection of neutral arbitrators.

34 As the unanimous Court of Appeal and the dissenting justices in the California Supreme Court recognized, the 1953 decision in *Wilko* was based on the Court's conclusion that arbitration of a securities claim might cause a claimant to waive the benefit of the unusually liberal venue provision in the Securities Act of 1933. (*See* App. 67a-68a,

tween a *federal statute* regulating contracts in interstate commerce and a *state law* purporting to limit the federal statute. Rather, *Wilko* involved two federal laws, and the Court in that case was simply called upon to determine whether a particular provision in the subsequently enacted federal Securities Act of 1933 superseded the parties' agreement to arbitrate. Thus, *Wilko* has no bearing on the Supremacy Clause issue presented herein.

The decision of the California Supreme Court is in conflict with the decisions of several other state and federal courts which have rejected the *Wilko* "analogy" in the context of conflicts between the Federal Arbitration Act and state anti-arbitration statutes. They have held that the states are not free to enact anti-arbitration statutes applicable to contracts involving interstate commerce, because the federal statute overrides the state law by virtue of the Supremacy Clause.

For example, in *Allison* v. *Medicab International, Inc.*, 92 Wash. 2d 199, 597 P.2d 380, 382-83 (1979), which involved a state franchise disclosure statute similar to California's, the Washington Supreme Court rejected plaintiffs' argument that the state statute rendered arbitration agreements unenforceable, succinctly noting:

> Plaintiff cites *Wilko* v. *Swan*, . . . where the Supreme Court refused to enforce an arbitration clause when the dispute arose under the federal securities act. However,

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31a-32a.) This Court has suggested that *Wilko* may have been based on that narrow ground. *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 513-14. The California Franchise Investment Law does not contain a broad venue provision similar to the one in the federal Securities Act.

Other courts have held that in view of the strong policy *favoring* arbitration, the *Wilko* "analogy" should not be extended to other situations. *See Ingbar* v. *Drexel Burnham Lambert Inc.*, No. 82-1279, slip. op. (1st Cir. July 28, 1982) (rationale of *Wilko* does not extend to claims under Commodities Exchange Act); *Romnes* v. *Bache & Co.*, 439 F. Supp. 833, 838 (W.D. Wis. 1977) (same); *Middle East Transcontinental, Inc.* v. *Onion Crock, Inc.*, 144 Mich. App. 57 (1982) (*Wilko* rationale inapplicable to claims under Michigan Franchise Investment Law).

> this case involved two federal acts and not as here the federal arbitration act and a state franchising act.
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> . . . .
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> We hold that the supremacy clause of the federal constitution must prevail and thus the federal arbitration act requires enforcement of the arbitration clause in the franchise agreement despite the judicial remedies afforded by the [state] Franchise Investment Protection Act.

The same reasoning was applied by a federal court in *Barron* v. *Tastee Freez International, Inc.*, 482 F. Supp. 1213, 1216-17 (E.D. Wis. 1980), in holding that the Federal Arbitration Act prevails over any anti-arbitration policy of the Wisconsin Franchise Investment Act.

In the instant case, the three-judge panel of the California Court of Appeal, as well as the two dissenting justices in the state Supreme Court, agreed that the federal policy favoring arbitration supersedes any effort by California to prohibit arbitration of disputes to which the Federal Arbitration Act applies. (App. 31a-37a; 66a-70a.) *See also, e.g., Bache Halsey Stuart Shields, Inc.* v. *Moebius*, 531 F. Supp. 75 (E.D. Wis. 1982); *R.J. Palmer Construction Co.* v. *Wichita Band Instrument Co.*, 7 Kan. App. 2d 363, 642 P.2d 127 (1982); *Merrill Lynch Pierce Fenner & Smith Inc.* v. *Melamed*, 405 So. 2d 790 (Fla. Dist. Ct. App. 1981). In these and many other cases (a few of which are cited at App. 32a-37a), the courts have almost uniformly held that the Federal Arbitration Act establishes national substantive law that prevails over any contrary state policies.

In support of its conclusion that the California statute is not preempted by federal law, the California Supreme Court mistakenly relied on this Court's decision in *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117 (1973). (App. 17a-18a.) *Ware* simply held that the particular state statute at issue in that case was not preempted by a particular federal statute because there was no conflict between them. *Ware* is

plainly distinguishable from the case at bar, which involves a direct federal-state conflict, and indeed, the preemption principles summarized in that case dictate the opposite conclusion here.[35]

As the Court noted in *Ware*, preemption depends on whether the state statute "frustrates any part of the purpose of the federal legislation." 414 U.S. at 139. The Court has similarly articulated the standard in other cases. For instance, in *Perez* v. *Campbell*, 402 U.S. 637 (1971), it was stated that a state statute is void under the Supremacy Clause if it " 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' " 402 U.S. at 649, quoting *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941). The Court reiterated this test in its recent decisions in *Chicago & N.W. Transp. Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. at 317-18, and *Jones* v. *Rath Packing Co.*, 430 U.S. 519, 525-26 (1977). And in *Colorado Anti-Discrimination Comm'n* v. *Continental Air Lines, Inc.*, 372 U.S. 714, 722 (1963), the Court framed the issue in terms of whether the state enactment "is in direct conflict with federal law, . . . denies rights granted by Congress, or . . . stands as an obstacle to the full effectiveness of a federal statute."

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35 *Ware* involved an alleged conflict between a state Labor Code provision exempting wage disputes from arbitration and a New York Stock Exchange rule providing for compulsory arbitration of wage disputes between members of the exchange and their employees. This Court found that there was no conflict between the policies underlying the state statute and the policies underlying the federal securities laws (pursuant to which the stock exchange had promulgated its compulsory arbitration rule), and accordingly held that the state legislation was not preempted by the stock exchange rule.

Ware did not involve an alleged conflict between a state law and the Federal Arbitration Act. Therefore, as the California Supreme Court acknowledged, "the holding in the case is consequently not controlling here." (App. 18a.) (A likely reason why no issue under the Federal Arbitration Act was raised in *Ware* is the proviso in § 1 of the Act, which exempts from the coverage of the Act contracts of employment of workers engaged in interstate commerce.)

Under these principles, the California Franchise Investment Law must give way to the strong federal policy favoring arbitration. There is here a direct conflict between the state and federal statutes: One renders arbitration clauses in interstate franchise agreements unenforceable; the other provides that such agreements shall be "valid, irrevocable, and enforceable." Instead of supplementing federal remedies, the California franchising statute "denies rights granted by Congress." *Colorado Anti-Discrimination Comm'n*, 372 U.S. at 722. Finally, in view of the fact that Congress' objective in enacting the Federal Arbitration Act was to *expand* the availability of arbitration, it is plain that the California statute's constriction of that remedy, " 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' " *Perez* v. *Campbell*, 402 U.S. at 649.

The California Supreme Court held that although the Federal Arbitration Act overrides any state policy that might be hostile "to arbitration generally," the Act allows the states to adopt "exceptions" to the general principle of arbitrability. (App. 15a-16a.) The court made no effort to define the subject areas or scope of the permissible exceptions, and there is in fact no sound basis for allowing a state to chip away at the federal arbitration remedy piece by piece. Under the reasoning of the California court, a state might be prohibited from eliminating the right to arbitration in one fell swoop, but it would be allowed to do so by means of a series of "exceptions." This year's exception could be for franchisor-franchisee disputes, next year's could be for disputes between lenders and borrowers, and the following year the state might ban the arbitration of tort claims. In each instance, the state could easily identify a "public policy" favoring judicial resolution of the category of disputes.

The California court's decision would also impair arbitration by inviting "unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages." *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 517. A party desiring to

avoid arbitration could, through artful pleading, structure his claims so as to fit within one of the state-created "exceptions" to arbitration.[36] It would also encourage forum shopping since the enforceability of an arbitration agreement would often depend on whether the claim were brought in state or federal court. (*See* App. 35a.) *See also Merrill Lynch Pierce Fenner & Smith Inc.* v. *Melamed,* 405 So. 2d at 792-93. This Court should not countenance such results. Just as the stability of international business transactions would be undercut if one country were to refuse to enforce international arbitration agreements based on parochial concerns, *Scherk* v. *Alberto-Culver Co.,* 417 U.S. at 516-517, orderliness and predictability in interstate commerce would be impaired if individual states

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36 This case offers a good example of the possibilities for such maneuvering. The claim in this litigation is that Southland misled the plaintiffs by misstating and failing to disclose material facts at the time they franchised their 7-Eleven stores. Accordingly, the primary allegation in plaintiffs' original pleadings was that Southland had engaged in intentional and negligent fraud in violation of common law. However, after the trial court had ruled that claims based on the California Franchise Investment Law are nonarbitrable, new complaints were filed in two of the consolidated cases (*Coy* and *Scovis*); these pleadings contained a single count, based on the Franchise Investment Law. Plaintiffs' counsel candidly conceded to the trial court that they had phrased their claims as statutory violations, and not as common law causes of action, for the express purpose of avoiding their contractual commitment to arbitrate their disputes. *See* plaintiffs' "Memorandum of Points and Authorities in Opposition to Petition to Compel Arbitration," at 3-4 (filed July 17, 1978), where plaintiffs' attorneys stated:

> [M]ay these plaintiffs . . . avoid arbitration by limiting their complaints to causes of action under the Franchise Investment Law? The answer to this question is clearly: yes, of course they can. . . . Having had the benefit of guidelines provided by the Court, plaintiffs' counsel have filed pleadings best calculated to both present the essential claims of the particular plaintiffs involved, and to plead an effective class action . . . .

were free to create "exceptions" to the arbitrability of disputes involving interstate contracts."

State-created "exceptions" would fly in the face of the express language of Section 2 of the Federal Arbitration Act, and would also violate the intent of Congress, which was to provide for the uniform treatment of interstate arbitration agreements among the states. If this policy is deemed to be unduly broad, California's remedy is not to enact its own contradictory legislation, but to petition Congress to modify the law to permit the states to restrict the permissible subjects of arbitration.

CONCLUSION

The decision of the California Supreme Court opens the door to widespread efforts by state legislatures and courts to declare various areas of interstate commerce to be "off limits" for arbitration under the Federal Arbitration Act. In addition, the California court's ruling would saddle the remaining, arbitrable disputes with burdensome, self-defeating, judicial class action procedures. The court's ruling on both issues is in conflict with decisions of numerous other courts, which have given full effect to the strong policy favoring arbitration embodied in the federal statute.

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37 In the instant case, the court below suggested that plaintiffs might be able to avoid their duty to arbitrate altogether—both with respect to their statutory claims and their common law claims—by asserting a claim under the Franchise Investment Law. (App. 18a n.15.)

For these reasons, we respectfully submit that this appeal presents substantial legal issues requiring full consideration by this Court.[38]

Respectfully submitted,

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September 1982

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38 If this Court should conclude that this case does not fall within its appellate jurisdiction, Southland requests that this jurisdictional statement be treated as a petition for a writ of certiorari, in which case jurisdiction is invoked pursuant to 28 U.S.C. § 1257(3) (1976). *See* 28 U.S.C. § 2103 (1976).